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No. 265

In the Supreme Court of the United States

OCTOBER TERM, 1941

FEDERAL POWER COMMISSION AND ILLINOIS COMMERCE COMMISSION, PETITIONERS

v.

NATURAL GAS PIPELINE COMPANY OF AMERICA AND TEXOMA NATURAL GAS COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of the Federal Power Commission, and the Attorney General of Illinois, on behalf of the Illinois Commerce Commission, pray that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Seventh Circuit, entered in this case on April 14, 1941, vacating and setting aside an order of the Federal Power Commission reducing the rates charged by the respondents.

OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 4026–4041) is not yet reported. The memorandum

opinion of the Federal Power Commission is found at R. 3925–3942.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 14, 1941 (R. 4041). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether, in issuing a rate order under the Natural Gas Act, the Federal Power Commission is required to include within the rate base a separate allowance for "going-concern value."

2. Whether, in determining the annual allowance for amortization, the Commission may compute the allowance on the basis of the entire service life of the capital assets or only on the basis of the remaining life from the date of the passage of the Natural Gas Act of June 21, 1938, or from the date of the rate order.[1]

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[1] A third question, which is reserved for argument on the merits if this petition be granted, is whether, on judicial review of a rate order of the Commission under Section 19 (a) of the Natural Gas Act, the order may be vacated for failure to make an allowance or adequate allowance for certain items of value or cost, in the absence of a finding that the rates permitted by the order are confiscatory, unjust, or unreasonable.

STATUTE INVOLVED

The pertinent provisions of the Natural Gas Act of 1938, c. 556, 52 Stat. 821, 15 U. S. C., Supp. V, §§ 717–717w, are set forth in the Appendix.

STATEMENT

The respondent companies are operated as a single enterprise (R. 11, 3999). They own and operate, and originally constructed, a natural gas pipe line, running from Texas and Oklahoma to Illinois (R. 3998). Three-quarters of the gas transported through the pipe line is produced from the respondents' own gas reserves in the Texas Panhandle, and one-quarter, produced in the same field, is purchased from a third company (R. 3998–3999). This gas is transported through the pipe line in interstate commerce, and 98% of it is sold at wholesale to utility companies which resell to the public for domestic, commercial, and industrial use (R. 3998–3999).[2] The respondents have their principal places of business in Chicago, Illinois (R. 1, 9). There is no dispute as to these facts and no question is raised that respondents are engaged in interstate commerce (cf. R. 4010).

The Natural Gas Act of 1938 declares that the "business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest," and that federal regula-

[2] About 90% of the gas is sold to an affiliated pipe line company in Illinois which resells to affiliated utility companies (R. 2–3, 9).

tion of interstate commerce in gas is "necessary in the public interest" (Sec. 1 (a)). The Act requires that all rates and charges in connection with the transportation or sale of gas subject to the Act must be "just and reasonable," and declares any rate or charge that is not just and reasonable to be unlawful (Sec. 4 (a)). The Federal Power Commission, on its own motion or on the complaint of a state, municipality, state commission, or gas distributing company, is empowered to investigate the rates charged, and to determine just and reasonable rates; the Commission "may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates" (Sec. 5 (a)).

On September 23, 1938, the Illinois Commerce Commission, pursuant to sections 5 (a) and 13 of the Act, filed with the Federal Power Commission a complaint charging the respondent gas companies with exacting unjust and unreasonable rates and praying for an order determining fair, just, and reasonable rates (R. 1–6). On October 14, 1938, the Federal Power Commission itself instituted an investigation of respondent's rates (R. 6–9). After answer denying most of the material allegations of the complaint (R. 9–12) the two proceedings were consolidated for hearing (R. 13–14).

Hearings were begun on May 8, 1939, and continued intermittently for over five months, ses-

sions being held on some 56 days (R. 3994–3995). Respondents fully presented their case, producing 37 witnesses (R. ii–iii; 187–1976) who testified on every phase of the business. On October 6, 1939, counsel for respondents announced that they had concluded their direct testimony (R. 4004). Thereafter seven of their witnesses were cross-examined and reexamined, and counsel for the two commissions presented four witnesses, who testified largely on the proper rate of return (R. 4004). On November 7, 1939, counsel for the two commissions jointly moved, on the evidence then of record, and without closing their case, for an immediate interim order reducing the rates (R. 3903–3914). Thereafter hearings were held at which respondents cross-examined the Commission's witnesses, and presented redirect and rebuttal testimony of their own, also mainly on the rate of return (R. 4004–4005, 3927). The final record before the Commission comprised 211 exhibits and over 10,500 pages of transcript of testimony. Oral argument on the motion was had before the full Commission and respondents filed pleas to the jurisdiction of the Commission to enter the requested order (R. 3914–3919), as well as an answer on the merits (R. 3920–3924), and briefs on both points (R. 3927, 4006).

On July 23, 1940, the Commission issued its memorandum opinion (R. 3925–3942) and an interim order reducing rates (R. 3942–3946). After making subsidiary and ultimate findings, including

a finding that the companies' rates were "unjust, unreasonable and excessive" (R. 3945), the Commission ordered the respondents to reduce their rates sufficiently to reflect a reduction of at least $3,750,000 per annum in operating revenues, and to file new schedules of rates carrying into effect this reduction (R. 3945–3946). The order also provided that the record was to "remain open for such further proceedings as the Commission may deem necessary or desirable" (R. 3946).

For the purposes of the interim order, the Commission "reluctantly" accepted (R. 3936) the following estimates presented by respondents' own witnesses:

Reproduction Cost New of Physical Properties (exclusive of Gas Reserves)	$56,302,250
Value of Gas Reserves as of June 1, 1939	13,334,775
Capital Additions from June 1, 1939, to December 31, 1942	3,808,399
Working Capital	975,000

These items total $74,420,424, which the Commission adopted as the rate base (R. 3937, 3944). The rate base urged by the companies was $82,291,553 (R. 3935). The companies' own recorded book cost of the properties, plus working capital, in existence as of December 31, 1939, was $60,952,279 (R. 3937).

The Commission refused to include in the rate base two items urged by the respondents: $8,500,000 for "going concern" value and $2,237,887 for average future capital expenditures from 1943 to 1954, the date claimed by the respondents for the exhaustion of their gas reserves and the termination of their business. The Commission character-

ized the claim for an allowance for "going concern" value as "arbitrary" and a "deceptive fiction", and added that it was convinced that it was allowing in the rate base "more than an adequate amount to cover all elements of value", and that the rate base allowed was "liberal" (R. 3936–3937).

The Commission fixed 6½% as the fair rate of return (R. 3938–3940).

The Commission accepted the companies' own estimate of the life of their business, 23 years (1932–1954), and their figures for total past and future capital expenditures, less salvage, $78,284,009 (Exh. 140, R. 3021).[3] From this it calculated the annual allowance for amortization to be $1,557,852, using the sinking fund method, with interest at 6½% per year, compounded annually (R. 3937–3938). The term "amortization allowance" was used to mean the allowance for depreciation, depletion, and retirement expense (R. 3937).

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[3] This total may be reconciled with the recorded book cost of the companies' properties plus working capital, in the sum of $60,952,279 as of December 31, 1939, as follows (in round figures):

Book cost of existing properties plus working capital at December 31, 1939	$60,950,000	(R. 3937)
Retirements actually made (1932–1939)	6,650,000	(R. 2959, 2821)
Future capital additions (1940–1954) per companies' estimates	8,535,000	(R. 3025, 2821)
Future capital replacements and contingencies (1940–1954) per companies' estimates	3,200,000	(R. 3027, 3021)
Total	79,335,000	
Less salvage, per companies' estimate	1,050,000	(R. 3021)
	78,285,000	

Pursuant to section 19 (a) of the Act, the companies filed an application for a rehearing (R. 3961–3993). Upon the denial of this application (R. 3993–3994), respondents petitioned the Circuit Court of Appeals for the Seventh Circuit for a review of the Commission's order (R. 3997–4009). The Circuit Court of Appeals upheld (1) the validity of the Natural Gas Act under the Fifth Amendment, (2) the authority of the Commission to issue an interim order reducing rates, (3) the propriety of setting 6½% as the fair rate of return, and (4) the propriety of putting the initial burden of setting up the rate schedules upon the companies. The court below vacated the Commission's order, however, on the sole grounds (a) that a separate allowance for "going concern value" of $8,500,000 should have been included in the rate base, and (b) that the period of amortization chosen should not have been the entire life of the business, but rather either the period beginning with the passage of the Act or the period commencing with the date of the rate reduction order. The court made no finding that the reduction would result in unjust, unreasonable, or confiscatory rates.[4]

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[4] The court found it unnecessary to consider two other grounds of attack urged by respondents: (i) that capital additions from 1943 to 1954 should have been included in the rate base, (ii) that 2% instead of 6½% interest should have been used in calculating the amortization allowance.

REASONS FOR GRANTING THE WRIT

1. The decision below requiring a separate allowance of $8,500,000 for going-concern value is in conflict with the decisions of this Court. This Court has repeatedly held that a separate allowance for going-concern value is not required in a rate valuation where, as here, the physical assets have been appraised "as part of an assembled whole." *Columbus Gas & Fuel Co.* v. *Public Utilities Commission,* 292 U. S. 398, 411; *Driscoll* v. *Edison Co.,* 307 U. S. 104, 117; *Denver Union Stock Yard Co.* v. *United States,* 304 U. S. 471, 478–480; *St. Joseph Stock Yards Co.* v. *United States,* 298 U. S. 38, 62–4; *Dayton Power & Light Co.* v. *Public Utilities Commission,* 292 U. S. 290, 308–9; *Los Angeles Gas & Electric Corp.* v. *R. R. Comm'n,* 289 U. S. 287, 313–319; *Galveston Elec. Co.* v. *Galveston,* 258 U. S. 388, 393–7; *Des Moines Gas Co.* v. *Des Moines,* 238 U. S. 153.[8] Moreover, the going-

[8] Ample evidence that the rate base adopted did and was intended to reflect the value of the physical property "as part of an assembled whole" is found in the Commission's adoption, as its basis of valuation, of respondents' estimate of reproduction cost, which was $13,500,000 in excess of the original investment (R. 3937) and which included, in addition to labor and material costs, large allowances for overheads, such as interest, taxes, and administrative, legal, supervisory and "preliminary operations" (R. 1224–1231, 1234), and the Commission's declaration, in rejecting the companies' claim for a separate allowance for "going concern value," that the rate base included "more than an adequate amount to cover all elements of value" (R. 3936–3937). The opinion below states (R. 4039) that the Commission did

concern allowance approved by the court below was calculated on the basis of interest and return assumed to have been unearned in the past and other deficiencies in past earnings, previously included in operating expenses, during the period of business development (R. 1276–1282; 1327–1337; 2943–2947), a method which this Court has specifically condemned. *Galveston Elec. Co.* v. *Galveston,* 258 U. S. 388, 393–397; *Columbus Gas & Fuel Co.* v. *Public Utilities Commission,* 292 U. S. 398, 411–413.

The court below correctly assumed that, under the decisions of this Court, going concern value need not be included as an item in the rate base "in the ordinary public utility case" (R. 4038). It distinguished the instant case upon the grounds that the life of respondent's business is fixed and rather short, that the investment is speculative, and that in the early years respondent had not been subjected to federal regulation (R. 4038–4039). The distinctions are without substance. The life span of the business and its speculative nature are relevant only to the period to be used as a basis in the determination of the annual amortization allowance, and to the fair rate of return (see *Galveston Elec. Co.* v. *Galveston,* 258 U. S.

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not include going value, as shown by the Commission's findings as to the composition of the rate base and the reasons which it assigned for rejecting the companies' claim for a separate allowance for "going-concern value." Quite evidently, however, this means only that the Commission failed to make a separate allowance for going-concern value.

388, 395–396), and the absence of federal regulation prior to the passage of the Natural Gas Act has no conceivable relation to the valuation of the physical assets, whether the appraisal be based on "present value" or investment.

The question whether a separate allowance must be made for going concern value is one of substantial importance in the administration of the Natural Gas Act of 1938. This is the first rate proceeding under the Act to reach the courts. There are now pending before the Federal Power Commission natural gas rate cases, in various stages of investigation and hearing, involving companies with properties valued at about one billion dollars, and whose annual revenues total several hundred million dollars, and other proceedings will no doubt be instituted in the future. The weight to be given the element of going concern value must necessarily be determined in every case. The Commission has assumed that, under the decisions of this Court, an appraisal of the property as "part of an assembled whole" was sufficient. The court below has now held that these decisions are limited to the "old and well-established field of public utility regulation" (R. 4038). In concluding that a different result was required in the case of respondent, the court below deemed it necessary to "blaze through new and untraveled fields of regulation of quasi-public businesses" (R. 4038) in view of the "newness and lack of

precedent among the conditions similar to those found in this industry" (R. 4039). The factors which were thought to require this conclusion, the life span of respondent's business, its speculative character and the absence of federal regulation in the early years, may be found in similar measure in the case of substantially all utilities subject to the Natural Gas Act. Whether such a far-reaching departure from the principles heretofore established in other fields of utility regulation is required in the case of the natural gas industry is a question which should be authoritatively determined by this court.

2. The decision of the court below (R. 4039–4041) that the period used as one of the bases in determining the annual amortization allowance must not include the years prior to the enactment of the Natural Gas Act likewise presents a novel question of vital importance in the administration of the Act. With immaterial exceptions, the utilities subject to the Act had all been engaged in the natural gas business for a number of years prior to the passage of the statute in 1938. If allowance must be made, in the years remaining after that date, for the amortization of the total capital investment theretofore made and the cost of past service thus charged to present consumers, effective rate regulation of the natural gas industry will be virtually nullified.

It is not clear why the court below condemned the amortization allowance. The decision perhaps was

placed upon the ground that it was based on "original investment" rather than "present value" (see R. 4040), and perhaps on the ground that an amortization allowance which assumed the maintenance of reserves prior to regulation was retroactive legislation (see R. 4040–4041). In either case, these are considerations which would apply in every rate proceeding under the Natural Gas Act.

The effect of the decision, whatever its basis, is to require a method of determining amortization or depreciation allowance which is in conflict with the prevailing practice of the industry and of the regulatory bodies[6] and which would gravely impair the effectiveness of utility regulation under the Natural Gas Act. The decision presents in aggravated form the occasion for the salutary principle that the courts "are not required to enter a debatable field of fact and to choose and prescribe an invariable method of computation." *Clark's Ferry Bridge Co.* v. *Public Service Commission*, 291 U. S. 227, 240. So far as *United Railways* v. *West*, 280 U. S. 234, is deemed to support the decision below it can no longer be regarded as controlling.[7]

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[6] *Clarksburg Light & Heat Co.* v. *Public Service Commission*, 84 W. Va. 638, 100 S. E. 551, PUR 1920A 639, 649–653; *Re Ashtabula Gas Co.* (Ohio) PUR 1917D 790, 796–7; *Fuhrmann* v. *Iroquois Natural Gas Co.* (N. Y.) PUR 1919D 76, 93.

[7] As indicated above (*supra*, p. 2), the Government will urge, in the event this petition is granted, that the Commission's order did not require the establishment of rates

CONCLUSION

For the foregoing reasons it is respectfully submitted that the petition for a writ of certiorari should be granted.

CHARLES FAHY,
Acting Solicitor General.
GEORGE F. BARRETT,
Attorney General of Illinois.

JULY 1941.

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below "the lowest reasonable rates" and that the finding of the Commission that the rates permitted by the order are just and reasonable is supported by substantial evidence, with the consequence that the court below, under Sections 5 (a) and 19 (b) of the Natural Gas Act, was without authority to set aside the order of the Commission.

APPENDIX

The Natural Gas Act of 1938, C. 556, 52 Stat. 821, 15 U. S. C. Supp. V, §§ 717–717w, provides:

SEC. 1. (a) As disclosed in reports of the Federal Trade Commission made pursuant to S. Res. 83 (Seventieth Congress, first session) and other reports made pursuant to the authority of Congress, it is hereby declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest. (P. 821.)

* * * * *

SEC. 4. (a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful. (P. 822.)

SEC. 5. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural gas company in

connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates. (Pp. 823–824.)

* * * * *

SEC. 6. (a) The Commission may investigate and ascertain the actual legitimate cost of the property of every natural-gas company, the depreciation therein, and, when found necessary for rate-making purposes, other facts which bear on the determination of such cost or depreciation and the fair value of such property.

(b) Every natural-gas company upon request shall file with the Commisison an inventory of all or any part of its property and a statement of the original cost thereof, and shall keep the Commission informed regarding the cost of all additions, betterments, extensions, and new construction. (P. 824.)

* * * * *

SEC. 9. (a) The Commission may, after hearing, require natural-gas companies to carry proper and adequate depreciation and amortization accounts in accordance with such rules, regulations, and forms of account as the Commission may prescribe. The Commission may from time to time ascertain and determine, and by order fix, the proper and adequate rates of depreciation and amortization of the several classes of property of each natural-gas company used or useful in the production, transportation, or sale of natural gas. Each natural-gas company shall conform its depreciation and amortization accounts to the rates so ascertained, determined, and fixed. * * * (P. 826.)

* * * * *

SEC. 13. Any State, municipality, or State Commission complaining of anything done or omitted to be done by any natural-gas company in contravention of the provisions of this Act may apply to the Commission by petition, which shall briefly state the facts, whereupon a statement of the complaint thus made shall be forwarded by the Commission to such natural-gas company, which shall be called upon to satisfy the complaint or to answer the same in writing within a reasonable time to be specified by The Commission. (P. 827.)

* * * * *

SEC. 19. (a) Any person, State, municipality, or State commission aggrieved by an order issued by the Commission in a proceeding under this Act to which such person, State, municipality, or State commission is a party may apply for a rehearing within thirty days after the issuance of

such order. The application for rehearing shall set forth specifically the ground or grounds upon which such application is based. Upon such application the Commission shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing. Unless the Commission acts upon the application for rehearing within thirty days after it is filed, such application may be deemed to have been denied. No proceeding to review any order of the Commission shall be brought by any person unless such person shall have made application to the Commission for a rehearing thereon.

(b) Any party to a proceeding under this Act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. * * * No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of

the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission, and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 346 and 347). (Pp. 831–832.)

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